

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
HENRY A. AND MARIANNE ITTLESON	:	DETERMINATION DTA NO. 819283
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Year 1997.	:	

Petitioner Henry A. Ittleson, 1185 Poco Sabo Lane, Green Pond, South Carolina 29446, and petitioner Marianne Ittleson, deceased, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under Article 22 of the Tax Law and the Administrative Code of the City of New York for the year 1997.

On October 27, 2003 and October 30, 2003, respectively, petitioners, appearing by Michael I. Saltzman, Esq., and the Division of Taxation, appearing by Mark F. Volk, Esq. (Kevin R. Law, Esq., of counsel), consented to have the controversy determined on submission without a hearing. All documentary evidence and briefs were submitted by March 10, 2004, which date began the six-month period for issuance of this determination. After due consideration of the record, Timothy J. Alston, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly determined that the nonresident petitioners' gain from the sale of a painting was New York source income pursuant to Tax Law § 631(b)(1)(A) and therefore subject to New York personal income tax under Tax Law § 601(e).

FINDINGS OF FACT¹

1. Petitioner Henry A. Ittleson currently resides at 1185 Poco Sabo Lane, Green Pond, South Carolina (the “South Carolina residence”).

2. Petitioner Marianne Ittleson is deceased.

3. Until April 14, 1997, petitioners held title to a cooperative unit at 812 Park Avenue, Apartment 11-D, New York, New York (the “New York apartment”).

4. In no later than December 1996, petitioners became residents and domiciliaries of South Carolina. Prior to such time, they were residents and domiciliaries of New York City.

5. In January 1993, petitioners visited South Carolina and decided to make their home in South Carolina. They hired a real estate agent to begin a search for a satisfactory property in South Carolina.

6. In March 1994, petitioners identified the South Carolina residence as a potential new home. The acquisition of the South Carolina residence would involve their moving out of New York State and New York City.

7. On March 28, 1994, petitioners entered into a lease, with an option to purchase, the South Carolina residence. The option provided that petitioners could purchase the property no earlier than April 1, 1996 and no later than March 1, 1997.

8. From 1994 through 1996, petitioners caused substantial renovations to be made to the interior and exterior of the South Carolina residence.

¹ The facts in this matter are not in dispute. The Findings of Fact herein include those contained in a Stipulation of Facts dated October 30, 2003 which was submitted by the parties and other relevant facts in the record. Petitioners submitted proposed findings of fact numbered “1” through “16” which are generally consistent with the stipulated facts. To the extent that such proposed findings of fact differ from the stipulation, the stipulation controls.

9. In March 1996, renovations to the South Carolina residence were completed to petitioners' satisfaction.

10. Also in March 1996, petitioners moved most of their personal property to the South Carolina residence.

11. On May 8, 1996, petitioners offered the New York apartment for sale, having listed it with Sotheby's International Realty.

12. In December 1996, petitioners ceased using the New York apartment as their principal residence.

13. On December 23, 1996, petitioners received notification that their application for South Carolina voters registration had been processed.

14. Also in December 1996, petitioners received an offer for the purchase of the New York apartment.

15. On January 17, 1997, petitioners entered into a contract with a buyer for the sale of the New York apartment. The building in which the New York apartment was located was a cooperative, and the buyers could not actually purchase the apartment until such purchase was approved by the cooperative's board. Closing was therefore scheduled for April 14, 1997.

16. On March 1, 1997, petitioners obtained title to the South Carolina residence.

17. On March 14, 1997, petitioners closed on the purchase of the South Carolina residence after taking title. Petitioners closed after taking title on March 1, 1997, for the convenience of the seller.

18. On May 5, 1986, petitioners purchased a painting entitled "Jeanne Hebuterne Con Grande Cappello" (1918) by Amedeo Modigliani (1884-1920) ("the Painting"). The cost of the Painting was \$1,525,319.00.

19. When they were making renovations to the South Carolina residence during 1994 through 1996, petitioners made no suitable provision for hanging a valuable painting in the climate of the South Carolina residence. No space for hanging the Painting at the South Carolina residence was made. Also, at the time that petitioners' personal property was moved from their New York apartment to the South Carolina residence, petitioners took no steps to move the Painting to the South Carolina residence.

20. In May 1996, when petitioners retained Sotheby's to sell the New York apartment, petitioners also decided to sell the Painting through Sotheby's.

21. Petitioners kept the New York apartment furnished while the apartment was being shown for sale. The Painting hung in the New York apartment until March 7, 1997.

22. On March 7, 1997, petitioners' Painting was sent to Sotheby's in advance of signing a consignment agreement.

23. On March 18, 1997, a consignment agreement was entered into between petitioners and Sotheby's.

24. Sotheby's exhibited the Painting from at least March through April 1997 in various cities outside New York and some cities outside the United States. The cities and dates the Painting was exhibited were as follows: Tokyo, March 26-27, 1997; Los Angeles April 1-4, 1997; Paris, April 7-8, 1997; London, April 10-13, 1997; and Zurich, April 16-17, 1997.

25. From March 26, 1997 through April 17, 1997, the Painting was located outside New York.

26. After the exhibitions, Sotheby's prepared to auction the Painting and brought it back to New York City for auction to be held on or about May 13, 1997.

27. On May 13, 1997, the Painting was sold at auction for \$8,522,682.00 on behalf of petitioners at Sotheby's auction house in New York City.

28. The sale of the Painting at auction generated a gain to petitioners of \$6,997,363.00.

29. Petitioners also sold or caused to be sold several pieces of artwork and collectibles. The total gain realized by petitioners on all of the sales was approximately \$7,099,897.00, virtually all of which was attributable to the Painting.

30. On October 4, 2001, following an audit, the Division of Taxation ("Division") issued to petitioners a Notice of Deficiency which asserted \$494,432.83 in additional New York State and City income tax due for the year 1997, plus interest of \$138,973.96, for a total amount due of \$633,406.79. The deficiency resulted from the Division's determination on audit that petitioners' gain on the sales of the Painting, artwork and collectibles was subject to New York State and City income tax.²

31. Petitioners filed a timely request for conciliation conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS"). Following a conciliation conference on October 18, 2002, BCMS issued a conciliation order which modified the subject deficiency to \$483,871.49, plus interest.

32. On audit the Division found petitioners to be domiciled in New York City and State through August 31, 1997. Subsequent to the conciliation conference and throughout this proceeding the Division has conceded that petitioners were domiciled in South Carolina as of January 1, 1997.

² The parties apparently agree that the New York tax treatment of the gain on the sale of the collectibles should follow that of the Painting.

SUMMARY OF THE PARTIES' POSITIONS

33. Petitioners assert that the Painting was temporarily in New York and only for the purpose of sale. As such, the Painting did not have a sufficient relationship with New York for the gain from its sale to be considered New York source income to petitioners who were, at the time of the sale, nonresidents of New York. Petitioners also assert that the Division's Audit Manual supports their position that the gain from the sale was not New York source income.

34. Petitioners further assert that "the purpose of the Tax Law would not be served" by the taxation of the gain on the sale of the Painting because, among other reasons, it would discourage the use of New York auction houses by nonresidents. Petitioners note that, given its unique nature, artwork such as the Painting has received special treatment under both Federal and New York estate tax law.

35. In response, the Division asserts that the gain from the sale of the Painting was New York source income within the plain wording of the statute, i.e., the Painting was in New York. The Division disputes petitioners' claim that the Painting had become disassociated with New York or that it lacked a sufficient nexus with New York at the time of the sale. The Division further distinguishes the instant matter from a case where a nonresident sends artwork to a New York auction house for sale. The Division notes that petitioners had been residents of New York where the Painting was located and that the Painting did not follow petitioners to their new domicile. The Division asserts that petitioners could have physically moved the Painting to South Carolina, but did not. The Division thus implies that the sale of the Painting by a New York auction house following the removal of the Painting to South Carolina would not have been subject to New York tax.

36. In reply, petitioners assert that the temporary removal of the Painting to South Carolina and subsequent return to New York for sale was not feasible under the circumstances and further assert that New York personal income tax should not be governed by such artificialities.

CONCLUSIONS OF LAW

A. The New York source income of nonresident individuals, such as petitioners, is subject to New York personal income tax (Tax Law § 601[e]). Such income includes the net amount of “items of income, gain, loss and deduction” reported in Federal adjusted gross income that are “derived from or connected with New York sources” (Tax Law § 631[a]). New York source income includes “items of income, gain, loss and deduction” attributable to “the ownership of any interest in real or tangible personal property in [New York]” (Tax Law § 631[b][1][A]).

B. The Painting is tangible personal property. Accordingly, under Tax Law § 631(b)(1)(A) the gain from its sale would be New York source income if such gain were attributable to petitioners’ ownership of the Painting in New York. The record in this matter, however, shows that the Painting lacked sufficient nexus to New York to support taxation of petitioners’ gain on its sale.

Due process requires “some minimal connection” between that which the State seeks to tax and the taxing State itself (*see, Quill Corp. v. North Dakota*, 504 US 298, 306). There is no such minimal connection here. The Painting was in New York solely for the purpose of sale. At the time of the sale, petitioners were domiciled in South Carolina and had sold their New York residence. Accordingly, petitioners had no permanent place of abode and no place in New York to keep the Painting for any extended period. Furthermore, prior to the sale, the Painting had been removed from New York for exhibition around the world and returned to New York solely

for auction at Sotheby's, thus clearly establishing that the Painting's presence in New York was solely for sale.

The Division's own Income Tax District Office Audit Manual supports the foregoing conclusion. The Audit Manual provides that where tangible personal property is located in the State on a temporary basis and is not connected with a trade or business, the gain from the sale of such tangible personal property is not New York source income. As an example, the Audit Manual notes that where a nonresident (who is not an art dealer) consigns a piece of art to a New York auction house for sale, such sale is not treated as New York source income. The facts in the instant matter are consistent with this example.

C. The Audit Manual also contains a second example which provides that the sale of the same piece of artwork would be considered New York source income "if it were located in the nonresident's New York apartment for an extended period of time." The Division touts this example in support of its position herein. The facts in the instant matter are distinguishable from this latter example, however, for the Painting was not located in a *nonresident's* apartment for an extended period. Petitioners became nonresidents as of January 1, 1997. The Painting hung in petitioners' New York apartment until March 7, 1997, when Sotheby's took custody. Petitioners kept the Painting in the New York apartment (which was itself in the process of being sold) for the sole purpose of securely storing it until Sotheby's took possession. The approximate nine-week period during which the Painting was stored in petitioners' nonresident New York apartment pending possession by Sotheby's, i.e., January 1 through March 7, 1997, was not "an extended period of time" sufficient to trigger New York income tax liability upon the sale of the Painting. Furthermore, from March 26, 1997 through April 17, 1997, the Painting was outside New York on exhibit. It became completely disassociated from New York at that point and its subsequent return for auction was unquestionably temporary.

Obviously the Painting was located in New York for an extended period, i.e., from the time of its purchase by petitioners in 1986 until its removal by Sotheby's in March 1997. Critically, however, petitioners were New York residents until December 1996. At that point petitioners became nonresidents subject to tax only on their New York source income. The Painting was thus located in the apartment of a New York resident for an extended period, but was located in the apartment of a nonresident only temporarily. Accordingly, the example discussed above is distinguishable from the instant matter.

The location of the Painting during the time petitioners were New York residents is not relevant to a determination of whether, after petitioners became nonresidents, the gain from its sale is New York source income. If it were, then the gain from the sale of any tangible personal property by a former New York resident would potentially be subject to New York income tax, no matter how brief or tenuous its connection to New York, so long as the sale transaction occurred in New York. Such an outcome would not only violate constitutional principles of due process, but would also, without basis in the Tax Law, transform the tax on income into a transaction tax roughly akin to the sales tax.

D. Due process further requires that the income attributed to the State for tax purposes must be rationally related to the protection, opportunities, and benefits given by the State (*see, Zelinsky v. Tax Appeals Tribunal*, 301 AD2d 42, 753 NYS2d 144, *affd* 1 NY3d 85, 769 NYS2d 464, *cert denied* ___ US ___, 124 S Ct 2068; *Quill Corp. v. North Dakota, supra*). Here, the income claimed by the Division to be New York source income, i.e., the entire amount of petitioners' gain on the sale of the Painting, is not rationally related to the benefits flowing to petitioners from New York. Specifically, New York provided a location for the temporary storage and subsequent sale of the Painting. Sotheby's New York location for the auction and

sale did not create any value for the Painting. Rather, such value was created by the international art market as shown by the international exhibition of the Painting prior to its sale.

E. The petition of Henry A. and Marianne Ittleson is granted and the Notice of Deficiency dated October 4, 2001 is canceled.

DATED: Troy, New York
July 1, 2004

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE